



Office of the Inspector General

Commonwealth of Massachusetts

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A Local Official's Guide to Procuring and Administering Audit Services

May 2004



The Commonwealth of Massachusetts
Office of the Inspector General

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Dear Public Official:

The Office of the Inspector General prepared this guide to help local officials understand the procurement rules for hiring Certified Public Accountants (CPAs).

Procurement rules are spelled out in Massachusetts General Law (M.G.L.) Chapter 30B, the Uniform Procurement Act. The law is designed to promote competition and integrity in state and local contracting and purchasing.

All of the approximately 1,500 municipalities, local jurisdictions, and local public agencies have at one time or the other used the services of a CPA or other accounting professional. Through our Chapter 30B advisory and training programs, we have identified that confusion exists about the procurement rules for hiring CPAs, which are somewhat different from the rules governing other services. This guide seeks to:

- Clarify Chapter 30B's narrow exemption for some services provided by CPAs;
- Explain circumstances when CPA contracts must be competitively procured;
- Recommend methods for hiring audit firms and managing audit services contracts; and
- Identify resources for local officials looking to hire CPA firms.

The Office of the Inspector General is charged with preventing and detecting fraud, waste, and abuse in state, county, and local government. When possible, we emphasize prevention. We hope this guide assists local officials in preventing problems before they occur.

I hope that this advisory is helpful. As always, I welcome your suggestions. Please do not hesitate to contact my staff with any questions you may have.

Sincerely,

Gregory W. Sullivan

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Inspector General

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SECTION ONE

Audit Services and Chapter 30B

M.G.L. Chapter 30B, the Uniform Procurement Act, establishes procedures that most local government jurisdictions must follow for the procurement of supplies, equipment, and services, the disposition of surplus supplies, and real property acquisitions and dispositions. Chapter 30B contains an exemption for the services of Certified Public Accountants.¹ According to the American Institute of Certified Public Accountants (AICPA):

CPAs are the chosen professionals, who help guide and manage organizations by utilizing their broad understanding of business combined with their ability to interpret its language (accounting). CPAs serve the business community in a multitude of roles. They are involved in assurance services (e.g., financial audits, webtrust), financial planning (e.g., tax returns, estate planning, financial reporting), technology (e.g., information management, electronic commerce, systems implementation), expert consulting (e.g., business valuation, litigation support, ABC costing), and advisory consulting (e.g., strategic planning, marketing, employee compensation, organizational development).²

This description of a CPA's role is applicable to government auditing and accounting as well as to business.

Although CPAs provide an array of professional services, not all services provided by CPAs are exempt from Chapter 30B. **It is the opinion of the Office of the Inspector General (OIG) that the CPA exemption applies only to services that could reasonably be restricted exclusively to CPAs, such as your jurisdiction's annual financial audit, single audit, or attestation service.** Attestation engagements concern examining, reviewing, or performing agreed upon procedures on a subject matter or an assertion. This would include forensic audits and other specialized work by CPAs. **Other contracts with CPAs are not exempt simply because a CPA is chosen to perform the service.** Although CPAs may have expertise in a wide variety

¹ M.G.L. c.30B, § 1(b)(15).

² American Institute of Certified Public Accountants, *Audit and Accounting Guide: Audits of State and Local Governmental Units*, revised edition, (January 1986).

of areas, using a CPA to provide their expertise to computerize an accounting system is a service that is subject to Chapter 30B since the service is not exclusively performed by a CPA. The planning and implementation of the accounting system may require the advice and assistance of a CPA, but the contract would primarily be for software development and integration. Since CPA expertise is not the primary factor in this type of procurement, the law requires that a competitive procurement be conducted.

Additionally, the exemption is only applicable if the accounting or auditing professional is a CPA. **Contracts with accountants, bookkeepers, performance auditors, management consultants, and other types of consultants who are not CPAs do not qualify for a Chapter 30B exemption even if these contracts are for services sometimes performed by CPAs.** Also, you should ensure that when you contract with a CPA or CPA firm, that a CPA and not another professional provides the service for which you contracted. If a non-CPA provides the service, the contract would not be exempt from Chapter 30B.

For non-CPA auditing or accounting contracts estimated to cost \$25,000 or more, a competitive procurement process using an Invitation for Bids (IFB)³ or Request for Proposals (RFP)⁴ is required. Chapter 30B requires three price quotations for contracts estimated to cost less than \$25,000 but more than \$5,000. Contracts costing \$5,000 or less must be entered into using sound business practices. As a general policy, the OIG encourages the use of competitive procedures even when their use is not legally mandated. Sample and model IFB's and RFP's exist for these types of services.

The Government Finance Officer's Association (GFOA) developed a model RFP for use in public purchasing. Although this is an excellent starting point for your procurement, you must ensure the model RFP complies with state law and local

³ An IFB process requires selection of the lowest-priced bid from a responsive and responsible bidder who meets the purchase description.

⁴ A RFP process allows an award of a contract to a responsive and responsible bidder who submits the most advantageous proposal, taking into consideration factors in addition to price.

ordinances and that the proposed scope of work and contract conditions meet the needs of your jurisdiction.

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SECTION TWO

Recommendations for the Procurement of Audit Services

In the public sector, auditing is important because of the substantial number of government programs and services and the vast sums of taxpayers' money spent by federal, state, and local governments. There is a need to ensure that governmental programs and services are managed properly and that taxpayer's money is spent wisely. Auditing has therefore become an integral part of governmental accountability.⁵

The OIG recommends the competitive procurement of audit services, including such services provided by CPAs even though CPA services are excluded from the provisions of Chapter 30B. The OIG recommends that all audit, consulting, and accountancy procurements and contracts incorporate the following suggestions:

- 1) Government Auditing Standards (GAS) Section 1.15 notes that, "sound contract award and approval procedures, including the monitoring of contract performance, should be in place" when contracting for audit services. Your procurement process and/or vendor contracts should, at a minimum:
 - (a) ensure that the scope of services is clearly defined;
 - (b) ensure that vendor reporting responsibilities and points of contact are clearly defined;
 - (c) identify vendor performance standards;
 - (d) ensure that the experience of the vendor staff is adequate;
 - (e) require that the vendor adhere to applicable audit and industry standards;
 - (f) verify that the vendor has participated in a peer review process whereby its own auditing process and procedures are reviewed by an external quality control review team and that any noted exceptions have been addressed by the vendor; and
 - (g) clearly define the work product requirement along with the expected delivery date.

⁵ Auditor of the Commonwealth, *Report of Agency Audit Activity in the Commonwealth of Massachusetts*, (May 17, 1990), No. 89-6008-9.

2) Since the mid-1980's, substandard government audit work performed by CPAs has concerned the U.S. General Accounting Office (GAO) and AICPA. The GAO concluded that the substandard work could be attributed to CPAs unfamiliar with government standards and poor procurement procedures that did not stress professional qualifications and competence. In fact, the GAO found that substandard audit work affected jurisdictions with poor procurement procedures three times more often than those with strong procurement procedures. The GAO suggested, in part, that:

- (a) competitive solicitations should be comprehensive and convey all audit requirements;
- (b) specific technical factors should be used to select a qualified firm;
- (c) agreements with audit providers should be in writing;
- (d) audit committees should be considered to plan and oversee the audit procurement process; and
- (e) detailed procurement guidelines should be formulated.⁶

3) Cost alone should not be the sole determinate when procuring audit services for your municipality. The quality of the training, expertise, and the credentials of the personnel proposed by the vendor should be considered by your jurisdiction in addition to cost. Cost alone should not dictate your decision, but cost is a legitimate factor to consider.

4) The Massachusetts Division of Professional Licensure has a Board of Registration in Public Accountancy (www.mass.gov/reg/boards/pa). This Board grants certificates and licenses to practice public accountancy to individuals who comply with statutory requirements. More than 12,000 accounting professionals are currently registered. The Board of Registration may revoke, suspend, and/or discipline registrants that did not comply with statutory requirements and/or

⁶ In response to this GAO suggestion, the Government Finance Officer's Association (GFOA) and the National Association of State Auditors, Comptrollers, and Treasurers (NASACT) jointly produced the *Audit Management Handbook* (1989).

professional standards. If you require the services of a CPA, the OIG recommends you:

- (a) verify the registration status of a CPA (or CPAs) with the Board. At a minimum, the lead auditor or audit manager (the responsible party of the selected firm) should be registered in Massachusetts. A CPA registered in Massachusetts must certify under pains and penalties of perjury that he/she or the firm that employs them has undergone a quality review within the three-year period prior to registration or re-registration. This quality review needs to have been approved by an Oversight Board appointed by the Board of Registration;
 - (b) request information from the Board pertaining to any complaints filed against the CPA or any disciplinary action taken by the Board against the CPA;
 - (c) attach to any solicitation and contract with an audit service vendor (regardless of whether the vendor is a CPA) the Code of Ethics and Professional Conduct as promulgated by the Board and codified in the Code of Massachusetts Regulations (252 CMR 3.01-3.05); and
 - (d) request that the vendor provide evidence that it has complied with external (peer) quality review requirements of its accountancy certification.
- 5) In addition to general demographic and financial information about the municipality, the RFP or IFB should outline the following to assist in the management of an audit service contract:⁷
- (a) what specific services are being requested by the municipality;
 - (b) conflict of interest policies. Publications of the State Ethics Commission (www.mass.gov/ethics) may contain useful information;
 - (c) a clear scope of work and all potential scope issues for the contract;
 - (d) a clear schedule that the auditor must follow and other performance requirements;
 - (e) what type of data is available and in what format is it maintained by the municipality;
 - (f) specific requirements and format for a draft and final reports or work products;

⁷ See Appendix for a detailed source of information concerning the procurement of audit services, including suggested information to be contained in an RFP. This source is *Choosing an External Auditor*, Mid-America Intergovernmental Forum, (March 2000).

- (g) the reporting relationship between audit staff and municipal officials;
- (h) the payment and invoicing process. (Is this a lump sum or reimbursement contract? Is there a contract maximum payment?);
- (i) the duration of the contract and options for renewal. Some organizations recommend that services for annual financial reports should be awarded on a multi-year basis. However, many organizations, including the GAO, the Intergovernmental Audit Forum, and AICPA advise that contracts should be limited to a *maximum* of five years. The OIG supports this position and strongly recommends audit services be subject to a competitive procurement process at least every three but not longer than five years; and
- (j) requirements for the retention of auditor records and/or the disposition of auditor records beyond what is required by industry standards and practices.⁸ This may require a written agreement.

⁸ M.G.L. c.112, §87E.

SECTION THREE

Contract Administration

- 1) Your jurisdiction should give careful thought to the reporting relationships between your jurisdiction and the vendor. In most cases, the vendor should report to the governing body of your jurisdiction. The procurement of and the day-to-day supervision of the vendor can rest with staff. However, to avoid conflicts of interests, appearance issues, or any allegations of impropriety, the vendor should report to the governing body. In the event that the governing body itself is the subject of an audit, an objective and independent party should be chosen. In the wake of the accounting scandals associated with Enron, Tyco, Adelphia etc., we all must use care to ensure that external accountants and auditors remain independent. To help ensure this independence, work products should be reported to the widest possible audience. Reporting to a governing body helps to ensure this and places responsibility for the audit findings on the jurisdiction rather than any one individual.

- 2) When a contract exists between your jurisdiction and a CPA firm performing audit/attestation services, the CPA firm should conform to the requirements of the GAO's *Government Auditing Standards (Yellow Book)*. Those standards provide a framework to ensure that governmental auditors have the competency, integrity, and objectivity to plan, conduct, and report their work. It also establishes very specific limitations on the types of non-audit services that an audit firm can perform, in order to assure that independence is maintained.

- 3) When a contract exists between your jurisdiction and a service vendor, the OIG recommends that the vendor conform to many of the rules and regulations established by the oversight committee created by the Sarbanes-Oxley Act of 2002. The OIG recognizes that the Sarbanes-Oxley Act was written for publicly held corporations that are subject to Securities and Exchange Commission oversight that are audited by large, national firms. However, the OIG believes

that the Act can help to ensure good business practices for your municipality. Listed below are selected sections of the Act that the OIG believes are important when procuring audit services. The selections are not the only sections of the Act that should be followed, but these sections serve as a starting point for your jurisdiction to include in any audit service contract and/or procedure.

- (a) Section 201 of the Sarbanes-Oxley Act requires that a public accounting firm not engage in a non-audit service without pre-approval by the audit committee. The governing body of your jurisdiction should be required to grant this approval.
 - (b) Section 204 of the Sarbanes-Oxley Act states that each registered public accounting firm that performs an audit, should report the following to the audit committee:
 - (i) all critical accounting policies and practices to be used;
 - (ii) all alternative treatments of financial information within generally accepted accounting principles that were discussed with management officials, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the registered public accounting firm; and
 - (iii) other material including written communications between the registered public accounting firm and management, such as any management letter or schedule of unjustified differences.
 - (c) Section 301 of the Sarbanes-Oxley Act states that the audit committee shall establish procedures for the "receipt, retention, and treatment of complaints" received by the issuer regarding accounting, internal controls, and auditing.
 - (d) Section 302 of the Sarbanes-Oxley Act states that someone with authority needs to take responsibility for the audit reports. The OIG recommends that the audit committee take this responsibility.
- 4) The OIG recommends that each jurisdiction monitor the professional chosen to perform the audit service to ensure ongoing compliance with the audit agreement. The monitoring process should be ongoing through the conclusion of the audit. The following is a partial list of the potential benefits the OIG believes a monitoring system can provide for your jurisdiction:
 - (a) allows for the identification of potential problems with the quality of the audit work or other performance problems early in the process;

- (b) ensures that your jurisdiction is getting the services contracted for;
- (c) ensures that the audit reports are reliable and complete; and
- (d) ensures that the proposed staff performs the audit.

5) In mid-2002, the Audit Committee Institute published *Basic Principles for Audit Committees*, which offers a foundation for each audit committee to consider as they adopt their own "best practices." A selection of these principles is as follows:

- (a) the audit committee should be comprised of the right individuals to provide independence and objective oversight;
- (b) the audit committee must continually assess whether the "tone at the top" embodies insistence on integrity and accuracy in financial reporting;
- (c) the audit committee must demand and continuously reinforce the "direct responsibility" of the external auditor to the audit committee; and
- (d) audit committees must implement a process that supports their understanding and monitoring of the:
 - (i) specific role of the audit committee in relation to the specific roles of the other participants in the financial reporting process;
 - (ii) critical financial reporting risks;
 - (iii) effectiveness of financial reporting controls;
 - (iv) independence, accountability, and effectiveness of the external auditor, and
 - (v) transparency of financial reporting⁹.

⁹ National Association of Corporate Directors, Directors Monthly. *The Changing Roles of Audit Committee*. (November 2003). Volume 27 (11).

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SECTION FOUR

Listing of Selected Resources for Audit Service Procurement

- American Institute of Certified Public Accountants

www.aicpa.org

Audit and Accounting Guide: Audits of State and Local Government Units, revised edition, (January 1986).

Statement on Auditing Standards (SAS) No. 70, *Service Organizations*.

Statement of Position (SOP) 98-3, *Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards*. (March 17, 1998).

- Code of Massachusetts Regulations

252 CMR (2.13) (2.15) (3.01) (3.02) (3.03) (3.05): Board of Registration in Public Accountancy.

801 CMR 21.00: Procurement of Commodities or Services.

- Commonwealth of Massachusetts, Executive Office of Administration & Finance, Operational Services Division, *Uniform Financial Statements and Independent Auditor's Report, Audit and Preparation Manual*, (2001), (DPS-A027b, DPS-A028b).

www.mass.gov.eofa

- Council of State Governments, *Buying Professional and General Services - A Guide*, (1986).

www.csg.org

- Government Finance Officers Association

www.gfoa.org

A Finance Officer's Guide to the Audit Selection Process, (November 1982).

An Elected Official's Guide to Auditing, (1992).

An Elected Official's Guide to Internal Controls and Fraud Prevention (unknown).

Audit Management Handbook, (1989).

Diskette, Model Audit RFP.

- Malan, Roland, James Fountain, Donald Arrowsmith, Robert Lockridge, *Performance Auditing in Local Government*, (1984).
- Lowe, D. Jordan, Marshall A. Geiger, Kurt Pany, *View Summary: The Effects of Internal Audit Outsourcing on Perceived External Auditor Independence*, (November 1999).
- National Association of Local Government Auditors (NALGA), *So, You Think You Might Be Interested in Hiring a Performance Auditor – A Few Things to Consider*, (undated).

www.nalga.org

- National Intergovernmental Audit Forum, *How to Avoid A Substandard Audit; Suggestions for Procuring an Audit*, (May 1988).
- Massachusetts Office of the Inspector General (MAOIG), *Procurement of Supplies, Services, and Real Property* (Procurement Manual) - (17713-158-3M-June 1995-IGO).

www.mass.gov/ig

- Mid-America Intergovernmental Forum, *Choosing an External Auditor*, (March 2000).
- United States General Accounting Office (GAO)

www.gao.gov

CPA Audit Quality: A Framework for Procuring Audit Services. August 1987 (GAO/AFMD-87-34).

Government Auditing Standards (Yellow Book) (2003).

- United States Office of Management and Budget (OMB)

www.whitehouse.gov/omb

Circular A-102, Grants and Cooperative Agreements with State and Local Governments, (October 1994 amended through August 1997).

Circular A-110, Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and other Non-Profit Organizations, (November 1993 amended through August 1997).

Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, (June 30, 1997).

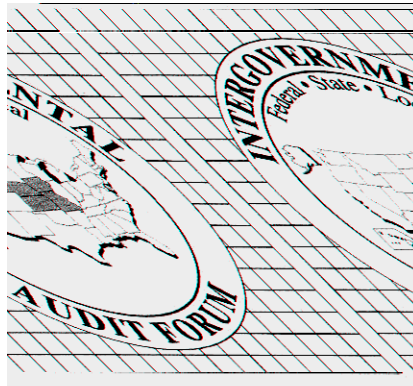
- Western Intergovernmental Audit Forum, *Guideline for Preparation of Requests for Audit Proposals*, (April 1985).

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APPENDIX

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Choosing an External Auditor



Guide for Making a Sound Decision

March 2000

Executive Summary

The benefits of having a high quality audit of a government's financial statements are both immediate and long-term. For example, high quality audits can result in recommendations for immediate improvements in management operations. Furthermore, high quality audits can result in increased accountability over government programs and long-term improvements in public confidence in government.

As a government official responsible for hiring an independent auditor, this guide will help you obtain the benefits of an audit that complies with all relevant professional auditing standards. It offers a five step process to help guide you to a quality audit.

Selecting a qualified auditor can be a very subjective process involving several factors. Government Auditing Standards issued by the General Accounting Office (GAO), noted that a sound procurement practice when contracting for audit services should, in addition to price, consider other factors including:

- 1) responsiveness of the bidder to the request for proposal,
- 2) past experience of the bidder,

- 3) availability of bidder staff with professional qualifications and technical abilities, and
- 4) results of the bidder's external quality control reviews

An American Institute of Certified Public Accountants (AICPA) task force report also discusses the importance of an auditor's experience and degree of specialization. The report noted that an auditor who spent less than 25% of their time on federal award audits was three times more likely to obtain a substandard assessment of audit quality as a result of external peer review.

To comply with OMB Circular A-133, which governs audits of expenditures of federal funds, a government entity must consider audit quality factors in addition to the price of the audit when choosing an external auditor.

We believe following this guide will help you meet your responsibilities, make a sound decision, and get your money's worth when hiring an independent auditor.

Mid-America Intergovernmental Audit Forum

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Mid-America Intergovernmental Audit Forum

Introduction

Regardless of the type or size of public entity you are affiliated with from the smallest town or local entity to the largest state or federal agency, from a neighborhood health clinic to a major hospital, from a grade school to a university-an effective audit can improve your operations and yield significant dollar savings. Selecting a qualified auditor will help you achieve the benefits of an effective audit and help you avoid wasting resources on auditors that cannot produce a quality audit. If your responsibilities include hiring an independent auditor, this guide can help you make a sound decision and get the most for your money.

Taking steps to ensure a quality audit is especially important in light of previous General Accounting Office (GAO) and President's Council on Integrity and Efficiency (PCIE) reports that have identified audit quality problems with government audits conducted by independent auditors. This was especially true when auditors were selected without following effective audit procurement practices.

Public entities should select auditors only after considering five basic steps for an effective audit procurement process, as follows:

Step 1: Planning (determining what needs to be done and when),

Step 2: Communicating Audit Requirements and Soliciting Proposals (writing a clear and direct solicitation document and disseminating it widely),

Step 3: Selecting a Qualified Auditor (authorizing a committee of knowledgeable persons to evaluate the ability of prospective auditors to effectively carry out the audit),

Step 4: Writing the Agreement: Documenting Expectations (documenting the expectations of both the entity and the auditor), and

Step 5: Monitoring the Audit: Ensuring a Quality Audit (periodically reviewing the progress of that performance).

This guide discusses these five steps of audit procurement. It also addresses the use of audit committees-independent committees composed of persons with knowledge of accounting, auditing, finance, or management-which, among other things, can assist entities in procuring audit services and overseeing the audit process. Many small entities-in this context, those that contract for audits costing less than \$10,000 - do not normally have procurement systems that are as formal as those of states or large local governments.

Special considerations may also need to be made when contracting for a Single Audit due to the significant changes made from the 1996 revision to the Single Audit Act (Public Law 104-156). Accordingly, this guide presents information at the end of each section on how the critical elements of a procurement system can be applied to the special needs of small entities and for Single Audits.

This guide includes a short bibliography of procurement guidelines. Keep in mind, however, that if the guidance provided conflicts with applicable laws or regulations or relevant grant conditions, the laws, regulations, or conditions are controlling.

Step 1: Planning

Planning to procure a quality audit requires time and attention. But the resources an entity spends on planning are likely to be rewarded by a smoother, more timely, higher quality, and often, less expensive audit.

Matters to Consider

- *Defining the entity to be audited.* Governments and other public organizations are often composed of numerous smaller, sometimes legally separate entities. You should decide which of these units to include in the scope of your audit, taking into account any legal requirements and generally accepted accounting principles.
- *Delineating the scope of the financial audit.*

For audits of financial statements, you need to determine whether you want the auditor to limit the examination to the general-purpose financial statements, the minimum allowable audit scope, or to extend the examination to cover additional statements, such as the combined, individual fund, and account-group financial statements, or other supplementary schedules.

- *Determining the specific audit requirements.* To determine your audit requirements - a sometimes difficult task-you may want to seek the assistance of knowledgeable persons. This assistance is ideally provided by an audit committee composed of people with backgrounds in accounting, auditing, finance, or management. Entities without audit committees may want to seek the assistance of other government personnel with specialized knowledge of accounting and auditing, the state auditor, or the state CPA society.
- *Deciding on the appropriate auditing standards.* While generally accepted auditing standards (GAAS) are typically used for both private and public sector audits, your organization may be subject to grant terms, state statutes, federal regulations, or the Single Audit Act and thus may be required to use government auditing standards (GAS) (commonly referred to as the "Yellow Book"), which are issued by the Comptroller General of the United States. GAS build upon GAAS and involve additional auditor responsibilities, including special reporting on internal controls and on compliance with applicable laws and regulations, contracts and grants. You should determine and specify the appropriate standards for your auditor to follow.
- *Identifying the attributes necessary in an auditor.* Personnel performing the audit should have experience with audits of similar entities and continuing professional education in governmental accounting and auditing. Moreover, they should comply with applicable requirements for peer review and continuing professional education.
- *Deciding how to evaluate prospective auditor.* Developing a systematic procedure for evaluating prospective auditors qualifications is essential. Although price is important, you should also consider: 1) The 4 factors identified in the Executive Summary; and 2) the results of the AICPA report noted in the Executive Summary.
- *Reviewing legal requirements.* You should review applicable laws, regulations, and grant conditions to ensure that both the procurement process and the audit itself will meet legal requirements.
- *Considering a multi year agreement.* The first year of an audit engagement usually involves significant start-up costs as auditors devote considerable time to learning about the entity and its internal control. Using this groundwork, the auditor may be able to perform the audit in less time and at less cost in the succeeding years. If authorized by law, a multi year agreement-perhaps a 1-year agreement with the option to extend the agreement for up to 5 years-has two advantages:
 - enables an auditor to propose a price that takes into account the savings to be realized in subsequent years, and
 - saves the entity the costs associated with repeating the selection process.

- *Evaluating the auditor rotation option.* Some people argue that changing auditors at the end of a multiyear contract infuses the audit process with fresh views and new perspectives. Others contend that these benefits can be achieved through internal rotation of audit staff and that maintaining a long-term, ongoing relationship with a particular auditor is more advantageous. A long-term relationship with an auditor, however, will not necessarily enable the entity to utilize appropriate competition to help ensure reasonably priced audits. It makes sense to carefully consider the advantages and disadvantages of auditor rotation as well as applicable legal requirements before setting a policy.
- *Establishing a work schedule.* A schedule should be established and agreed to by both the entity and the selected auditor, that sets forth dates by which certain milestones in the audit process must be reached. The only way to ensure the timely preparation and issuance of financial statements and related reports is to develop and adhere to such a schedule.

Additional Considerations For Small Entities

All of the foregoing suggestions-especially creating and using an audit committee-can help a small entity achieve a quality audit. Even the smallest organization can appoint a two- or three-person audit committee that understands what is to be audited and how the audit should be performed.

Additional Considerations For Single Audits

You will need to determine whether the Single Audit Act applies to your organization. The Single Audit Act of 1996, including OMB Circular A-133 issued in 1997, established supplemental audit requirements in the areas of internal control and compliance. In addition, it dramatically changed the funding thresholds for organizations subject to its requirements and the ways in which Federal programs are selected for audit coverage ("risk based approach"). This could significantly impact the scope of the audit, including increasing the complexity of the audit bidding/procurement process due to changing audit coverage of Federal programs.

OMB Circular A-133 requires auditees to follow the procurement standards set forth in OMB Circulars A-102 (State and Local Governments) and A-110 (Institutions of Higher Education, Hospitals, and Non-Profit Organizations). In addition to other requirements, these Circulars require auditees to make positive efforts, and whenever possible, to utilize small businesses, minority-owned firms, and women's business enterprises. A good source for information concerning these requirements can be found at OMB's web page at: <http://www.whitehouse.gov/OMB/>

OMB Circular A-133 allows the performance of a 'Program-Specific Audit' when an organization expends Federal awards under only one Federal program and no requirement exists for a 'financial statement audit' to be conducted. Otherwise, a Single Audit must be performed.

A good reference document to gain an understanding of the Single Audit requirements is the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 98-3.

Step 2: Communicating Audit Requirements and Soliciting Proposals

Full and open competition is basic to government procurement. Encouraging as many qualified auditors as possible to submit proposals for auditing your organization increases the likelihood that you will receive a quality audit at a fair price. You must clearly communicate your audit needs to potential proposers. This is critical, because auditors who do not clearly understand exactly what services you want, might not respond, or they may base their response on invalid requirements.

How to Solicit an Audit

There are many ways to solicit bids for your audit, but the most reliable method-and the one we suggest-is a written request for proposal, or RFP. RFPs should be clearly written; set forth all terms, conditions, and evaluation criteria as well as the scope of the work required; and be sufficiently well distributed and publicized to encourage full and open competition.

Using your audit committee to advise you when writing your RFP is a good idea. Committee members should have a clear understanding of both the audit function and what your organization requires of the audit.

You may want to consider compiling a list of potential auditors from general and professional directories and from your past experiences with audit firms. You should review the listing to see if it includes small businesses, minority-owned firms, and women's business enterprises so that they are made aware of any audit opportunities. Maintaining an updated list makes it easy to distribute your RFP to auditors that are most likely to be interested in performing your audit.

What to Include in Your RFP

The prime consideration in preparing your RFP is that it contains enough information to provide auditors with a common basis by which to prepare proposals that address all your audit needs. It is also important, however, that you consult with your purchasing office and/or legal counsel to ensure that your RFP conforms with the laws, regulations, and grant terms applicable to your organization.

In developing this guide, we evaluated RFPs used by several states in soliciting audit proposals. Our review noted that 'audit fees' typically accounted for 25-30% of the evaluation ranking, while the auditors' qualifications, including the articulation of their ability to perform the audit, accounted for 70-75% of the evaluation ranking.

At a minimum, your RFP should contain the following:

- the name and address of your organization;

- the entity to be audited, scope of services to be provided, and specific reports, etc., to be delivered;
- the period to be audited (with explanation if the RFP calls for a multi-year procurement);
- the name and telephone number of a contact person at your organization;
- the format in which you want proposals to be prepared;
- the address to which proposals should be delivered or sent;
- the date and time proposals are due;
- the number of proposal copies to be submitted;
- the criteria to be used in evaluating the bid and their relative importance to each other;
- the method and timing of payment; and
- any other important points, including the consequences if due dates are missed or work does not meet audit standards.

Your chances of receiving high quality proposals will be enhanced if you:

- explain the work that your organization does;
- explain what is to be audited, e.g., general-purpose financial statements, specific funds, or both;
- describe in some detail your organization's accounting system, administrative controls, records, and procedures. The RFP should identify the availability of proposer access to staff and records upon request;
- identify the appropriate auditing standards;
- inform prospective proposers if data from prior years (audit reports, management letters, etc.) will be available, whether major audit findings remain open from prior years, and whether any audits of subrecipients are required;
- notify prospective proposers of requirements for work paper retention and making the work papers available to the entity as well as governmental auditors if they request them;
- describe expected audit products, the required format of the audit report, and the format of any required progress reports;
- explain any assistance that your organization will offer, such as staff support to assist the auditor (which could materially reduce your audit costs); and

- outline the expected schedule of work (completing field work, issuing reports, etc.).

Finally, a well-prepared RFP will elicit certain information from prospective auditors. For example, it will ask prospective auditors to state:

- how they would conduct the audit and, if it were a multi year contract, how they would approach the work efforts of the subsequent year(s);
- their qualifications, those of their local office, if applicable, and those of the proposed audit staff, including their prior government auditing experience;
- whether they meet appropriate State licensing requirements in the State where the audit will be performed;
- their policies on notification of changes in key personnel;
- whether the proposed staff have received continuing professional education in governmental accounting and auditing during the last 2 years;
- whether they are independent, as defined by applicable auditing standards;
- that they have not been suspended or debarred from performing government audits, or from other government activity;
- whether they have received a positive peer review within the last 3 years;
- whether they have been the object of any disciplinary action during the past 3 years;
- whether they contract with small businesses, minority-owned firms, women's business enterprises to assist in performing audit work.
- their audit fees.

Proposers' Conference

Although you will have been as thorough as possible in preparing your RFP, you may overlook some information that prospective proposers will find useful. One effective way of communicating additional information to prospective proposers is to invite them to a proposers' conference, where you can provide additional information and they can ask questions. Although these purposes could be served by letters and individual conversations, bringing all prospective proposers together at the same time to hear the same information is efficient and helps ensure that all proposers are treated fairly. This is especially important, since unsuccessful proposers may challenge the procurement if their competitors were given significantly different or more information. Any notes or minutes from the proposers conference should be provided to all prospective proposers, whether in attendance at the conference or not.

Additional Considerations For Small Entities

Obtaining an extensive list of prospective proposers may be difficult for small entities in rural areas. Soliciting lists from nearby, larger entities and from the CPA society in your region often is helpful.

Furthermore, preparing a detailed RFP for a small engagement may be economically impractical in many cases. Abbreviated RFPs, designed for small engagements and requiring only a little tailoring to meet individual needs, may be available through state and regional government organizations.

At a minimum, such RFPs should clearly define the work to be done, including the reports and opinions to be delivered.

Additional Considerations For Single Audits

You should inform prospective proposers whether the Single Audit Act applies to this audit. If so, you should provide them with information concerning: Federal funding information; results of previous audits including the types of auditors opinions rendered on the financial statements and compliance with Federal laws and regulations, contracts and grants; identification of audit findings, etc. This information is necessary for prospective proposers to gain an understanding of whether your organization may qualify for 'low-risk auditee' status, including a general understanding of the Federal programs that may need to be audited as major Federal programs.

You may also want to describe how/who will be responsible for completion of the various parts of the Data Collection Form required to be submitted to the Federal Audit Clearinghouse.

Step 3: Selecting a Qualified Auditor

Once the due date for proposals has passed, you can begin evaluating the proposers' qualifications. The technical evaluation is important for two reasons:

- it provides a systematic framework for selecting an auditor on the basis of the entity's established RFP criteria, and
- it documents that the auditor was selected fairly.

Comparing your entity's requirements with the auditors' plans, skills, experience, commitment, and understanding of the audit requirements before reviewing their price proposals will help you select the auditor that can provide the best audit at the fairest price.

Consider Establishing an Evaluation Committee

To limit errors in judgment and to bring varied perspectives to the technical evaluation of the proposals, you will probably want to establish an evaluation committee. The committee should be composed of people with experience in accounting, auditing, budgeting, or another specialty field pertinent to the required audit work. Your audit committee can also play an important advisory role in this process.

Evaluation Qualifications Separately From Price

We suggest separate evaluations of 1) office qualification, 2) staff qualifications, and 3) audit fees. The office and staff qualifications address the auditors' technical ability to perform the audit. Although the price for the work to be performed is a factor in the selection of a qualified auditor, you will be more likely to get a high quality audit at a fair price if both price and technical ability are taken into account in selecting the successful proposer.

Screen Bidders For Minimum Standards

As a first step, you should require all proposers to meet certain minimum standards before evaluating either the technical qualifications or the price proposals. By doing so, you can spare your entity the needless and time-consuming technical evaluation of prospective auditors that do not meet your requirements. These minimum standards can be determined by the laws governing your entity, its general internal policies, and its policies regarding specific audit engagements. However you delineate them, your minimum standards should include that prospective auditors:

- meet state licensing requirements or other legal requirements enabling them to perform the audit,
- meet the applicable independence standard,
- have a record of responsible work, and
- comply with applicable requirements for peer review and continuing professional education.

Technical Criteria

The technical criteria set out in the RFP and used in the evaluation process can vary. At a minimum, however, the evaluation committee should be able to answer "yes" to the following questions:

Understanding the Audit Requirements

- Does the proposal (both in the statement of the audit requirements and elsewhere) demonstrate that the proposer has an understanding of the audit's objective(s), your organization's needs, and the final products to be delivered?
- Does the proposal show the proposer's intention to start the audit when required and complete the audit in a timely fashion?

Soundness of Technical Approach

- Does the proposal contain a sound technical plan and a realistic estimate of time required to complete the audit?

- Does the technical plan show a practical approach to meeting benchmarks and specific deadlines?
- Does the proposal indicate that the proposer will use (1) a systematic approach to examining systems and internal controls and (2) effective procedures, including consideration of risk and materiality, to determine the extent of audit testing and review necessary?
- Does the proposal indicate the proposer's willingness to use other auditors' work, to the extent possible, to avoid duplication of effort?

Qualifications of the Audit Organization

- Does the audit organization have experience in performing the required work for entities of your type and size? Evaluators should reserve the right to review supporting documentation for any experience claimed by the audit organization or its key personnel.
- Do prior clients have a positive opinion of the audit organization?
- Has the audit organization passed its latest peer review?

Qualifications of the Audit Team

- Does the proposal clearly show the collective experience of the team to be assigned to the audit?
- Does the proposal specify, in concrete language, that key personnel have education and experience in the type of work that the audit entails?
- Is the experience explained in terms of specific audit engagements?
- Is the continuing professional education of key personnel explained in detail?
- Does the proposal indicate the extent to which your entity's personnel would be expected to contribute to the work effort?
- Does the proposal specify that you must be notified in writing of changes in key personnel?
- If the proposal is for a multi year contract, does it provide an approach for planning and conducting the work efforts of the subsequent year(s)?

Rating the Proposals

Initial evaluations should be based on the proposers' proposals submitted. As you evaluate the proposals, make a list of strengths and weaknesses for each to support its technical rating. After you complete the technical evaluation and review the prices offered by the proposers, you may be prepared to select the proposal that is most advantageous to your entity.

If, however, you feel you need more information before selecting a proposal, you should hold individual discussions with proposers who have a reasonable chance of being selected to allow them to respond to your concerns and submit revised proposals by a specified date. Care should be taken during these discussions not to reveal proprietary information submitted by other proposers. You should then evaluate the revised proposals as described above and award the contract on the basis of both technical competence and reasonable price.

Additional Considerations For Small Entities

Using a committee to carry out the evaluation process is especially important for small entities with limited resources. A more comprehensive analysis of the proposals is likely to be achieved by having more people involved in the evaluation process.

Additional Considerations For Single Audits

When evaluating proposals, particular attention should be given to the proposers description of the methodology to be used in performing the 'risk-based' approach in determining major Federal programs. This will affect the Federal programs selected for review which could significantly impact proposed audit fees, etc. This is especially critical when comparing audit fees between proposers. Consideration should be given to contacting one of the Offices of Inspectors General (IG) within a Federal Agency if you have questions concerning the 'risk-based' approach or other Single Audit matters. A good source for identifying how to contact the various IG offices is the Inspectors General Network (IGnet) at: <http://www.ignet.gov/ignet/>.

In addition, effective for fiscal years beginning after June 30, 1998, OMB Circular A-133 prohibits an auditor who prepares the indirect cost proposal or cost allocation plan from being selected to perform the Single Audit when the indirect costs recovered by the auditee during the prior year exceeded \$1 million.

Step 4: Writing the Agreement: Documenting Expectations

The lack of a written agreement between the entity contracting for the audit and the auditor can contribute to problems. To foster sound and productive communication and to avoid misunderstandings, both parties should agree in writing on important audit related matters. Make clear at the start-before prospective proposers spend time assessing the nature of the job and estimating its costs-that you expect to sign a formal document at the culmination of the proposal process. Auditors unwilling to commit themselves to signing such a document are better avoided.

A signed agreement represents a contract and is binding upon both parties. For that reason, when drafting the agreement, seek the advice of your purchasing office or legal counsel on the agreement's form and substance.

What to Include in a Written Agreement

When an RFP has been used, the written agreement should incorporate by reference, the terms of the RFP and those of the successful proposer's last proposal. The agreement should be signed by the entity and the auditors and should clearly specify the:

- audit scope, objective, and purpose;
- deadlines for work to be performed;
- audit cost;
- report format;
- type and timing of support to be provided to the auditor by the entity; and
- professional auditing standards to be followed in performing the audit.

Furthermore, the agreement should make the following points about the auditor/entity relationship, changes in the kind or amount of work required, and access to and ownership of audit products.

- The relationship of the auditor to the entity is that of an independent contractor.
- At any time, the entity may, by written notice, make changes in or additions to work or services within the general scope of the agreement. If such changes are made, an equitable adjustment will be made in the cost of the audit using the rates specified in the agreement.
- If the auditor believes that a change in or addition to work is beyond the general scope of the agreement, it must notify the entity in writing within a specified time and before beginning that work. The agreement should indicate where the final administrative authority rests in deciding disputes.
- The work papers prepared by the auditor during the audit are its own property. These documents should be retained for a period to be designated in this agreement. Copies of these work papers (if requested) are to be made available to the entity and governmental auditors or regulators.
- All reports rendered to the entity by the auditor are the exclusive property of the entity and subject to its use and control, according to applicable laws and regulations.

Additional Considerations For Small Entities

In the absence of an RFP, many small engagements are documented only by an engagement letter prepared by the auditor that protects the auditor more than the entity being audited. If you decide to use an engagement letter as your written agreement, we advise including the information listed above and ensuring that the document is signed by both parties.

Additional Considerations For Single Audits

Information should be provided on how/who will be responsible for completion of the various parts of the Data Collection Form required to be submitted to the Federal Audit Clearinghouse.

Step 5: Monitoring the Audit: Ensuring a Quality Audit

Monitoring the progress of the audit is the most effective way to ensure that your organization receives both the type and quality of audit services specified in the written agreement. Key elements that you may wish to consider to ensure proper monitoring include:

- This is a role that your audit committee can carry out most effectively. This group of experts can evaluate the audit while it is taking place, thereby addressing and resolving problems before the audit is completed. It can also review audit results and assist in post audit quality evaluation. Thus, not only does the audit product improve, but working relationships between the audited entity and auditor are enhanced.
- Monitoring is especially beneficial during the first year of a new auditor's contract and during the audit of a particular unit or segment(s) of an organization that is unique or complex. Furthermore, monitoring is beneficial throughout the term of a multi year contract: It provides status reports and helps coordinate the auditor's activities with the audit's requirements. While auditors are responsible for ensuring the quality of the audit, monitoring work performed as a quality assurance measure is critical.
- Monitoring can be accomplished by requiring periodic progress reports, as well as by holding regular meetings to discuss issues that need to be resolved. Furthermore, meeting after the completion of the audit to discuss the draft report can help ensure a clear understanding of the report and its findings.

Additional Considerations For Small Entities

Few small entities have the resources to thoroughly monitor the work of an auditor. When audit committee members are unavailable within an organization, composing a committee from people outside the organization may be the answer.

Additional Considerations For Single Audits

Federal and State Agencies may perform quality review procedures for Single Audits for which they are the assigned Cognizant or specified Oversight Agency.

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